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# Germany is the real winner in a transfer union

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By Sebastian Mallaby

Over the past 18 months, Germany has tried every trick to limit its contribution to the euro bailouts. It has pushed self-defeating austerity onto bankrupt countries. It has called in the International Monetary Fund. It has tried to pass the hat to China. It has discovered an improbable and futile taste for leveraging up the European Financial Stability Facility. But now these tricks have uniformly failed, and the continent approaches the abyss – with Germany itself suffering the humiliation of a failed bond auction. It is time for Germany to decide once and for all: how much will it pay to save Europe?

Germans can reach the sensible answer only if they discard the myth, widely cherished in northern Europe, that peripheral southern countries are the undeserving beneficiaries of a charitable transfer union. You can see whence this myth comes: the Greeks do retire in their fifties; they did lie about their budget deficit; and it is galling when they demand serial bailouts. But despite those aerial photographs of untaxed Athenian swimming pools, the north's resentment of lazy southerners is overdone. The truth is that Germany derives myriad benefits from the currency union. It should pay more to save it.

Start with a simple point about exchange rates. Since 2009, stable open economies from Brazil to Switzerland have seen hot inflows of money and upward pressure on their currencies. If Germany had not been tethered to the euro, its money would have behaved like the Swiss franc, spoiling the recent party in its manufacturing heartland. Between August 2009 and May 2011, German exports jumped by 18 per cent. A reasonable estimate suggests they would have risen only 10 per cent if Germany had been outside the euro.

Conversely, if peripheral Europe had not been tethered to the euro, its currencies would have fallen over the same period. Rather than facing a financial shock and a crisis of competitiveness, they would have faced the first without the second. Of course, the currency union that makes adjustment in the periphery so excruciating is the very same currency union that handed Germany its export boom. Rather than condemning lazy southerners, the Germans should share the loot.

Germany has benefited more than it acknowledges through the monetary channel, too. During the euro's first decade, interest rates across the eurozone fell towards German ones, and low-saving southern countries appeared to derive a subsidy from the credit rating of high-saving northern ones. But, far from being a boon to the periphery, centralised monetary policy proved appropriate for the EU's mature core, but too loose for inflation-prone catch-up economies. By an irony that inflation-hating Germans have trouble seeing, Ireland and Spain suffered property and banking busts at least partly because monetary policy was too German. Rather than scorn the losers, Germany should compensate them.

Once the euro crisis began, the monetary dynamics reversed – but still favoured the Germans. As the issuer of Europe's remaining reserve assets, Germany has enjoyed a flood of capital inflows from the periphery, driving its 10-year government bond yield down to around 2 per cent, this week's auction notwithstanding. The resulting monetary stimulus arrived just when slowing global growth made it most welcome; this is Germany's version of the flight to quality that the US enjoys thanks to the dollar's status. Countries that benefit from international monetary arrangements should be prepared to invest in preserving them.

Contrast Germany's luck with the periphery's predicament. Before the euro, Portuguese families aiming to retire in escudos saved in escudos. This created a semi-captive customer base for escudo bonds – so Portugal's government could fund itself. But the euro's arrival dented savers' home bias and deprived Portugal of its own central bank. Portuguese savers who want euro assets can now buy them in Germany; and without a lender of last resort to back it, Portugal's government must pay frightened investors over the odds. The upshot is that Portugal's borrowing costs are far higher than when it had its own currency. Of course, the capital movements that pummel Portugal are the same ones that cushion lucky Germany.

So yes, the Germans have it right: Europe's currency union does indeed involve transfers. But it is not true that these transfers flow only one way. Germany pays out via bailouts and intra-regional transfers; but it also receives benefits via trade and monetary channels. If only Germany could accept this truth, it might yet muster the will to rescue the euro – and salvage a generation of efforts to build an integrated Europe.

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